(2)

Supreme Court, U.S.
FILED

NOV 12 2002

OFFICE OF THE CLERK

No. 02-315

IN THE

Supreme Court of the United States

OCTOBER TERM, 2002

FRIEDMAN'S INC. D/B/A FRIEDMAN'S JEWELERS, AMERICAN BANKERS INSURANCE COMPANY OF FLORIDA, INC., AND AMERICAN BANKERS LIFE ASSURANCE COMPANY OF FLORIDA

Petitioners,

v.

STATE OF WEST VIRGINIA *EX REL* JAMES DUNLAP,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Appeals of West Virginia

---

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

F. Paul Bland, Jr.
(Counsel of Record)
Michael J. Quirk
Trial Lawyers for Public Justice, P.C.
1717 Massachusetts Avenue, NW
Suite 800
Washington, D.C. 20036
(202) 797-8600

David Grubb
The Grubb Law Group
1324 Virginia Street, East
Charleston, WV 25301
(304) 345-3356

34pp

John W. Barrett
Barrett Law Firm, P.L.L.C.
227 Capitol Street
Suite 400
Charleston, WV 25301
(304) 414-3000

Brian A. Glasser
Bailey & Glasser, L.L.P
227 Capitol Street
Charleston, WV 25301
(304) 345-6555

TABLE OF CONTENTS

Page

INTRODUCTION 1

STATEMENT OF THE CASE 3

A. The Underlying Transaction Between the Parties .. 3

B. Petitioners' Mandatory Arbitration Clause 4

C. The State Court Proceedings 6

D. The Federal Court Proceedings 8

ARGUMENT 9

I. The Decision Below Invalidating a Prohibition on Punitive Damages Does Not Justify a Grant of *Certiorari* 9

A. The Decision Below Does Not Deepen Or Create a Split of Authority 9

B. The Decision Below Does Not Conflict with the Decisions of this Court 13

1. This Court Has Consistently Held That The FAA Does Not Alter Or Override Generally Applicable State Laws 13

2. This Court Has Consistently Stated That Arbitration Agreements Involve A Change In Forum But Not A Waiver Rights Under Substantive Laws 15

3. *Mastrobuono* Is Readily Distinguishable From This Case 16

II. The Holding of the Court Below that a Contractual Ban on Class Actions Prevents Parties from Effectively Vindicating their Substantive Rights Does Not Justify a Grant of Certiorari 17

A. The Decision Below Neither Creates Nor Deepens a Split of Authority 17

B. The Decision Below Is Consistent With this Court's Decisions 18

III. There is No Split of Authority on Whether the FAA Preempts State Contract Law Concerning Mutuality of Obligations and the Doctrine of Unconscionability 20

IV. The Lower Court's Ruling Is Supported by Three Independent Reasons, and if Any of Those Reasons Is Supported by Law then It Would Suffice to Justify the Result 24

CONCLUSION 25

TABLE OF AUTHORITIES

Cases **Page**

Allen v. Marshall Field & Co., 93 F.R.D. 438 (N.D. Ill 1982) 20

America Online v. Superior Court, 90 Cal. App. 4th 1 (2001) 17

Arnold v. United Companies Lending Corp., 511 S.E.2d 854 (W. Va. 1998) 21

Art's Flower Shop v. The Chesapeake and Potomac Telephone Co. of West Virginia, 413 S.E.2d 670 (W.Va. 1991) 10

Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704 (7th Cir. 1994) 10-12

Davis v. Prudential Securities, Inc., 59 F.3d 1186 (11th Cir. 1995) 10, 12

Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996) 2, 13

Dunlap v. Friedman's, 290 F.3d 191 (4th Cir. 2002) 8-9

EEOC v. Waffle House Corp., 534 U.S. 279 (2002) ... 3, 15

Flyer Printing Co. v. Hill, 805 So. 2d 829 (Fla. Ct. App. 2001) 24-25

In re Firstmerit Bank, 52 S.W.3d 749 (Tex. 2001) 22

First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995) 11, 14

General Securities Corp. v. Welton, 135 So. 329 (1931) 22

Gilman v. Wheat, First Securities, 692 A.2d 454 (Md. 1997) 18

Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991) ..... *passim*

Harris v. Green Tree Financial Corp., 183 F.3d 173 (3d Cir. 1999) 23

Johnson v. Junior Pocahontas Coal Co., 234 S.E.2d 302 (W.V. 1977) 10

Johnson v. W. Suburban Bank, 225 F.3d 366 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001) 18

Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995) 14, 16

Ex Parte McNaughten, 728 So.2d 592 (Ala. 1998) 22

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) 13, 15

Munoz v. Green Tree Financial Corp., 542 S.E.2d 360 (S.C. 2001) 22

Murphy v. North American River Runners, 412 S.E.2d 504 (W.V. 1991) 10

Paladino v. Avnet Computer Tech., Inc., 134 F.3d 1054 (11th Cir. 1998) 12

Penn v. Ryan's Family Steak Houses, Inc., 269 F.3d 753 (7th Cir. 2001) 12

Perry v. Thomas, 482 U.S. 483 (1987) 13-14

Popovich v. McDonald's, 189 F. Supp. 2d 772 (N.D. Ill. 2002) 25

Randolph v. Green Tree, 244 F.3d 814 (11th Cir. 2001) 18

Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6 (1st Cir. 1989) 10-12

Securities Indus. Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989) 12

Smithson v. U.S. Fidelity & Guar. Co., 411 S.E.2d 850 (W.Va. 1991) 7

Snowden v. CheckPoint Check Cashing, 290 F.3d 631 (4th Cir. 2002) 18

U.S. Life Credit Corp. v. Wilson, 301 S.E.2d 169 (W.Va. 1982) 10

Wilson Electrical Contractors, Inc. v. Minnotte Contracting Corp., 878 F.2d 167 (6th Cir. 1989) 22-23

Statutes and Regulations:

9 U.S.C. § 2 ..... *passim*

29 U.S.C. § 626(b) 20

29 U.S.C. §216(b) 20

Uniform Consumer Credit Code, § 5.108 comment 3 21

Other Materials

Restatement (Second) of Contracts § 184 cmt. b 25

West Virginia Attorney General, Annual Reports: 1999, *available at* www.state.wv.us/wvag/annual reports/ 1999/an99_litigation_Friedman.htmlg 4

INTRODUCTION

Notwithstanding the high-octane rhetoric in the petition for *certiorari* about how the decision below threatens an end to all arbitration in West Virginia, this case is not really about arbitration. If the decision below stands, Petitioners will still be able to hold their West Virginia customers to mandatory binding arbitration clauses if they so choose. The only limits imposed by the court below are that Petitioners may not (a) force customers to relinquish their right to seek substantive legal remedies, such as punitive damages awards; (b) take away from customers the right to seek class-wide relief through class action proceedings (whether in arbitration or in court); or (c) impose a one-sided arbitration system that gives Petitioners a choice of forum between court and arbitration for their claims against customers while forcing customers to go to arbitration for all of their claims against Petitioners.

None of these features is inherent or unique to arbitration; indeed, the vast majority of arbitration clauses commonly in use in the U.S. do not place limits on damages and apply equally to both parties. Other arbitration clauses also provide that consumers may pursue claims on a class action basis. As the opinion below makes clear, any of these provisions or features would have been unconscionable under generally applicable West Virginia law had they been contained in a contract that did not involve arbitration. Petitioners' position amounts to the following: even if West Virginia's general law of unconscionability would strike down such exculpatory and one-sided terms in a contract not involving arbitration, that law is overridden by the Federal Arbitration Act ("FAA") so long as such provisions are included in a section of a contract that *also* includes an arbitration provision. Nothing in the FAA permits parties to launder otherwise illegal contract terms and make them legal merely by sticking them under the heading of "arbitration," however, and this Court has never so held.

The opinion below is merely a determination of generally applicable state contract law by West Virginia's high court that comports with principles set forth in a large number of that court's decisions in cases not involving arbitration. None of the decisions from other jurisdictions cited by Petitioners involves determinations of West Virginia's state law of exculpatory clauses, and thus none of those decisions conflict with the decision below. In addition, most of the cases cited by Petitioners are inapposite. These cases relate to punitive damages involve decisions affirming awards of punitive damages, and most of the decisions cited by Petitioners relating to class actions involve interpretations of federal statutes that are entirely unrelated to this case.

The opinion below is also entirely consistent with this Court's decisions. This Court has consistently instructed that arbitration clauses need not be enforced if they violate generally applicable principles of state contract law, and do not allow claimants to effectively vindicate their substantive rights. That is what happened in this case. Accordingly, the question presented in the Petition for Certiorari does not warrant a grant of this Court's discretionary review.

First, this Court has held that the FAA permits states to apply generally applicable contract defenses to arbitration clauses. *See, e.g., Doctor's Associates, Inc. v. Casarotto,* 517 U.S. 681 (1996). Following *Doctor's Associates*, the court below applied such a body of state law to invalidate a limitation on liability. Friedman's portrayal of that decision as an attack by the state court on the Federal Arbitration Act ("FAA") is baseless. Instead, this Petition raises the question of whether the FAA overrides West Virginia's generally applicable contract law relating to exculpatory clauses. The court below held that West Virginia law forbids parties from entering into

any contract that denies parties the substantive right to recover punitive damages under West Virginia law. This prohibition on broad exculpatory clauses claims is a rule of law that West Virginia courts apply without respect to the forum in which a case is heard.

This Court has also consistently instructed that arbitration clauses are to be enforced only to the extent that they permit claimants to effectively vindicate their substantive rights. *See EEOC v. Waffle House Corp.*, 534 U.S. 279, 295 n. 10 (2002). Because the challenged provisions in Friedman's contract would not permit its customers to effectively vindicate their substantive rights under West Virginia law, the state high court's decision to bar such a waiver is entirely consistent with this Court's opinions.

STATEMENT OF THE CASE

A. The Underlying Transaction Between the Parties

Friedman's, Inc. ("Friedman's") is a jewelry store chain doing business in West Virginia. Respondent James Dunlap, a customer who purchased jewelry through an installment sales agreement, alleges that Friedman's has "been carrying out a systematic, deceptive, and illegal 'loan packing' scheme, with the purpose and effect of surreptitiously adding unrequested insurance charges to the cost of consumers' purchases from Friedman's." Petitioners' Appendix ("Pet. App.") 3a.

Dunlap alleged that Friedman's deliberately ordered its employees to conceal and lie about these added insurance charges. Pet. App. 4a. Dunlap supported these allegations with several sworn affidavits from former Friedman's employees who testified that Friedman's directed its employees not to

disclose these charges, *see* Pet. App. 4a-61, and to lie about them if asked. *E.g.*, Pet. App. 5a ("When I questioned what should we do if a customer questions the insurance, I was told that we should tell the customer that it was a computer error.")

The State Attorney General investigated the allegations and found that they were true, reporting that "[a] successful undercover sting operation conducted by this office verified illicit wrongdoing by Friedman's. The Division has further determined that neither Friedman's nor its employees have a license to sell insurance in West Virginia." West Virginia Attorney General, Annual Reports: 1999, *available at* www.state.wv.us/wvag/annualreports/1999/an99_litigation_Friedman.htmlg (last visited on 9/30/2002).

B. Petitioners' Mandatory Arbitration Clause

As part of its standard form installment sales contract with Dunlap and other customers, Friedman's included a mandatory arbitration clause. The arbitration provision begins by stating that it applies to all disputes arising out of the transaction between the parties:

> All disputes, controversies or claims of any kind or nature between Buyer and Seller, arising out of or in connection with the sale of goods financed or refinanced pursuant to the terms of this Agreement . . . or with respect to negotiation of, inducement to enter into, construction of, performance of, enforcement of, or breach of, effort to collect the debt evidenced by, the applicability of the arbitration clause in, or the validity of this Agreement or any earlier agreement (except as specifically set forth in paragraph 14 below), shall be resolved by arbitration

. . . .

Pet. App. 10a.

More than halfway down the paragraph explaining the parties' duties relating to arbitration, Friedman's inserted an exception to this obligation for many of its own claims:

> The Seller may exercise its right upon default by Buyer as set forth in the paragraph entitled "default" above, without resort to arbitration or mediation. Nothing in this paragraph shall be construed to prevent either party's use of bankruptcy or repossession, replevin, judicial foreclosure, non judicial foreclosure or any other prejudgment or provisional remedy relating to any collateral, security or property interests, for contractual debts now or hereafter and by either party to the other under this Agreement. . . .

Id. The arbitration clause thus restricts the rights of Dunlap and other customers by requiring them to arbitrate any legal claim they could ever assert against Friedman's. At the same time, it enhances the rights of Friedman's itself by allowing the company to choose among court, arbitration, or self-help remedies in asserting repossession and other property-based claims against its customers.

The arbitration clause concludes by imposing a limitation on the substantive remedies that are available to parties who must assert their claims through arbitration, stating that "[n]o arbitrator may make an award of punitive damages." *Id.* The arbitration clause thus limits the relief that is available to customers on all their claims while imposing no comparable

limitations on the claims Friedman's may bring in court. Similarly, the contract provides that "recovery hereunder by the buyer shall not exceed amounts paid by the buyer hereunder."

C. The State Court Proceedings

In the trial court, Dunlap opposed Petitioners' motion to compel arbitration on the grounds (among others) that the clause prohibited class actions, prohibited punitive damages, and was one-sided. In a brief two-page opinion, the trial court held that it was "not persuaded by Plaintiff's arguments that the arbitration clause is unfair or invalid." Pet. App. 44a.

On appeal to the West Virginia Supreme Court of Appeals, that court began with an analysis of the state's common law of unconscionability, Pet. App. 12a-13a, and then supplemented that analysis with an analysis of the provisions of the West Virginia Consumer Credit and Protection Act relating to unconscionable contract provisions. Pet. App. 13a-14a. The Court then analyzed West Virginia law with respect to contracts of adhesion, Pet. App. 14a-19a, noting that the principle that provisions in adhesive contracts that are outside of the reasonable expectations of the parties are unenforceable is "a provision of equity applicable to all contracts generally. . . ."

The Court then traced how these principles are applied to exculpatory provisions in contracts of adhesion. It reviewed a number of its own prior cases, none of which involved arbitration clauses, Pet. App. 19a-20a, establishing that "exculpatory provisions in contracts of adhesion are given close scrutiny, with respect to both their construction and their potential for unconscionability, particularly where rights, remedies and protections that exist for the public benefit are involved." Pet. App. 19a. The Court then explained that this

principal has been "reinforced by the public policy of this State, as enacted by the Legislature." Pet. App. 20a.

The Court next addressed Dunlap's argument that he had not knowingly, voluntarily and intelligently waived his right to a jury trial. It held that "we will for purposes of our decision give no weight to Mr. Dunlap's state constitutional rights to a jury trial in the public court system." Pet. App. 25a.

The Court then held that the provision in Friedman's arbitration clause prohibiting punitive damages was unconscionable, citing to one of its own prior cases (not involving arbitration) barring an insurance company from employing a similar contract provision to insulate itself from bad faith claims. Pet. App. 26a (citing *Smithson v. U.S. Fidelity & Guar. Co.*, 411 S.E.2d 850, 857 (W.Va. 1991)).

The Court then held that Friedman's arbitration clause was unconscionable, because by foreclosing class actions, it would prevent Dunlap from effectively vindicating his substantive rights. "In Mr. Dunlap's case, the total of $8.46 in insurance charges that Friedman's added to his purchase price by Friedman's is precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing." Pet. App. 27a.

The Court then rejected Petitioners' claims that the FAA preempted its holdings, noting that otherwise unconscionable and unenforceable contract provisions are not magically made legal "merely because the prohibiting or limiting provisions are part of or tied to provisions in the contract relating to arbitration." Pet. App. 31a.

In a footnote, the Court also held that the one-sided nature of the clause reflected that it "lacks even-handedness," and provided "additional and independently adequate grounds for our holding herein." Pet. App. 31a at n.12.

The Court then rejected Petitioners' request that it re-write the arbitration clause to strike the illegal provisions, noting that it was not authorized "to remake the parties' contract." Pet. App. 39a (citation omitted).

Finally, the Court clarified that its holding was not based on anything to do with arbitration, but was instead based on generally applicable law that would apply any time a contract banned punitive damages or class actions:

> We emphasize that the attempted avoidance of legally-required accountability for wrongdoing under the laws of West Virginia that Friedman's has attempted to accomplish with exculpatory arbitration-related provisions in a contract of adhesion in the instant case would be just as objectionable and unconscionable if that attempted avoidance arose from language that made no mention of arbitration.

Pet. App. 41a.

D. The Federal Court Proceedings

At the same time that it petitioned the state trial court to compel arbitration, Petitioners also decided to seek a separate adjudication of the case in federal court. The U.S. District Court dismissed Petitioners' Petition to Compel Arbitration, and that dismissal was affirmed by the U.S. Court of Appeals for the Fourth Circuit. *See Dunlap v. Friedman's*, 290 F.3d 191

(4th Cir. 2002). That Court also denied without comment Petitioners' requests for rehearing *en banc*.

ARGUMENT

I. The Decision Below Invalidating a Prohibition on Punitive Damages Does Not Justify a Grant of *Certiorari*.

A. The Decision Below Does Not Deepen Or Create a Split of Authority

The decision below is an application of generally applicable West Virginia state contract law involving contract provisions purporting to strip individuals of their substantive rights. Given that the West Virginia Supreme Court is the final authority as to matters of West Virginia contract law, there can be no split of authority on this point. In addition, each of the cases cited by Petitioners is readily distinguished from this one.

As set forth in the Statement of Facts, the West Virginia Supreme Court's opinion in this case is rooted in the generally applicable state common law of unconscionability and the provisions of the West Virginia Consumer Credit and Protection Act. Pet. App. 13a-14a. Both of these sources of West Virginia law have placed sharp limits on the use of exculpatory clauses in contracts of adhesion of any sort. The holding of the court below that a "no punitive damages" provision in a contract of adhesion is unconscionable is not rooted in principles of arbitration law, but is instead consistent with an unbroken line of West Virginia cases not involving arbitration, all of which held that similar exculpatory clauses are unconscionable.

In *Art's Flower Shop v. The Chesapeake and Potomac Telephone Co. of West Virginia*, 413 S.E.2d 670 (W.Va. 1991), for example, the Court held that a contractual provision limiting the phone company's liability to twice the cost of an advertisement was unconscionable as applied to a plaintiff bringing claims for much larger compensatory and punitive damages. The Court's holding in this non-arbitration case that the terms were "unreasonably favorable" to the defendant, 413 S.E.2d at 675, is entirely consistent with its holding in the instant case. *See also Murphy v. North American River Runners*, 412 S.E.2d 504 (W.Va. 1991) (exculpatory clause releasing defendant from liability for reckless behavior is void as against public policy); *U.S. Life Credit Corp. v. Wilson*, 301 S.E.2d 169 (W.Va. 1982) (credit contract waiving a borrower's statutory right to sue if the creditor published his indebtedness was unconscionable); *Johnson v. Junior Pocahontas Coal Co.*, 234 S.E.2d 302 (W.Va. 1977) (exculpatory clause could not insulate strip mining contractor for liability for damages to a nearby property). None of those cases involves an arbitration clause, and each establishes that the decision below here is simply an application of generally applicable state law involving exculpatory clauses. To the extent that none of the cases cited by Petitioners involves West Virginia law on this topic, there can be no conflict between these authorities, except to the extent that the FAA might ever be construed to preempt generally applicable state contract law.

In addition, nearly every case cited by Petitioners as allegedly conflicting with the decision below involve challenges to arbitrators' decisions awarding punitive damages to a party – factual circumstances that are entirely unlike those involved here. This is true of *Davis v. Prudential Securities, Inc.*, 59 F.3d 1186 (11th Cir. 1995); *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704 (7th Cir. 1994); and *Raytheon Co. v.*

Automated Business Systems, Inc., 882 F.2d 6 (1st Cir. 1989). (Cited in the Petition at 12-13.) Thus, none of these cases involved a challenge to an arbitration clause prohibiting punitive damages, or a body of state law prohibiting exculpatory clauses relating to punitive damages.

These cases are distinguishable on numerous other grounds as well. For example, several of them purport to be applications of federal common law, rather than state law. *See, e.g., Raytheon*, 882 F.2d at 11 n.5; *Baravati*, 28 F.3d at 707. As this Court has subsequently directed, however, generally applicable state law (like the West Virginia law at issue here) should govern the issues of unconscionability or contract enforcement. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) ("When deciding whether the parties agreed to arbitrate a certain matter . . . courts generally . . . should apply ordinary state-law principles that govern the formation of contracts.")

In fact, several of the decisions cited by Friedman's actually *support* the reasoning of the Court below here. For example, the principal point of the *Raytheon* case – that arbitrators should be permitted to award punitive damages – is entirely consistent with the West Virginia Supreme Court's decision here:

> [P]unitive damages can serve as an effective deterrent to malicious or fraudulent conduct. Where such conduct could give rise to punitive damages if proved to a court there is no compelling reason to prohibit a party which proves the same conduct to a panel of arbitrators from recovering the same damages.

Raytheon, 882 F.2d at 12.

Friedman's claim that the cases listed above conflict with the opinion below in this case is also belied by other decisions from those jurisdictions. Each jurisdiction recognizes that arbitration clauses may not prevent parties from effectively vindicating substantive rights, and each recognizes that arbitration clauses are not enforceable where they conflict with generally applicable state law. The *Raytheon* case was decided by the First Circuit, for example, which has recognized that generally applicable state laws may lead to the invalidation of particular arbitration contracts. *See Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1121 (1st Cir. 1989). The Seventh Circuit, which decided *Baravati*, has also struck down arbitration clauses that run afoul of "ordinary state law contract principles." *Penn v. Ryan's Family Steak Houses, Inc.*, 269 F.3d 753, 759 (7th Cir. 2001). The *Davis* case was decided by the Eleventh Circuit, which has struck down an arbitration clause that had "provisions that defeat the remedial purposes of the statute. . . ." *Paladino v. Avnet Computer Tech., Inc.*, 134 F.3d 1054 (11th Cir. 1998). Taken in context, then, there is no conflict between the opinion below and the complete body of law on this subject in any of the jurisdictions relied upon by Petitioners. Each of those courts endorses the principles relied upon by the court below – that arbitration clauses do not permit the drafters of contracts to eliminate other parties' substantive rights to remedies, and that courts may refuse to enforce clauses that attempt to eliminate such rights under generally applicable rules of state contract law, without running afoul of the FAA.

In short, Petitioners have identified no authority that conflicts with the West Virginia Supreme Court's decision.

B. The Decision Below Does Not Conflict with the Decisions of this Court.

1. This Court Has Consistently Held That The FAA Does Not Alter Or Override Generally Applicable State Laws.

The West Virginia Supreme Court's holding that a court may not enforce a contractual provision prohibiting the award of punitive damages under state law is a routine application of the Federal Arbitration Act's express provisions and this Court's interpretations of the Act.

Section 2 of the FAA states that contractual arbitration clauses are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The West Virginia Supreme Court's decision below is consistent with this command of the FAA and this Court's opinions interpreting the Act to subject contractual arbitration provisions to the same rules of state law that apply to other contracts. In *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), this Court explained that Section 2 of the FAA places arbitration agreements on the same footing with other contracts so that "generally applicable contract defenses such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Id.* at 687. Likewise, in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), this Court highlighted Section 2's savings provision and warned that "'courts should remain attuned to well-supported claims that the agreement resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract.'" *Id.* at 33 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) (internal quotation omitted)). In *Perry v.*

Thomas, 482 U.S. 483 (1987), the Court held that state law applies to arbitration clauses covered by the FAA "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally," while the Act only preempts those rules or principle of state law that "take [their] meaning precisely from the fact that a contract to arbitrate is at issue." *Id.* at 492 n.9 (emphasis in original). The Court has since held on numerous occasions that the FAA applies state contract law to determinations regarding the interpretation and enforceability of arbitration agreements.[1]

As Part C of the Statement of the Case and Part I-A of the argument, *supra*, make plain, West Virginia law forbidding parties from waiving liability for punitive damages is generally applicable to all contracts, whether they involve arbitration or not. Thus, the decision below is not directed against arbitration, but against a limitation on liability that is not uniquely related to arbitration. Petitioners suggest that the state court here was not applying generally applicable law, but was instead acting out of hostility to arbitration. But that is not so. This Petition, therefore, does not truly focus on arbitration, but instead on West Virginia general state contract law for exculpatory contracts.

---

[1] *See, e.g.*, *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 and 63 n.9 (1995) (applying Illinois and New York common law rule that ambiguous language should be construed against contract's drafter); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (applying Illinois and Pennsylvania law to determination of scope of arbitration clause).

2. This Court Has Consistently Stated That Arbitration Agreements Involve A Change In Forum But Not A Waiver Of Rights Under Substantive Laws.

This Court has stated that arbitration is acceptable as an alternative to litigation in court because it is simply a "different forum" – one with somewhat different and simplified rules, but nonetheless one in which the basic mechanisms for obtaining justice permit a party to "effectively vindicate" his or her rights. *See, e.g., EEOC v. Waffle House Corp.*, 534 U.S. 279, 295 n. 10 (2002); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991), *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985). The Court has explained that "by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Gilmer*, 500 U.S. at 26. Petitioners' arbitration clause in this case falls far short of this baseline standard.

Numerous lower courts have interpreted this Court's direction in the same manner as the Court below, and directly contrary to the approach urged by Friedman's. In case after case, courts around the nation have applied this Court's jurisprudence to hold that arbitration provisions which limit a party's access to substantive legal remedies that are available in court may not be enforced. *See* Pet. App. 15a-17a (citing more than a dozen U.S. Courts of Appeal or U.S. district court opinions making this point). These cases – just like the West Virginia Supreme Court's decision below – merely followed this Court's guidance that arbitration is to be favored and allowed only where it is just another forum for adjudicating a party's statutory rights, not a means of denying those rights.

3. *Mastrobuono* Is Readily Distinguishable From This Case.

Friedman's claims that the decision below conflicts with this Court's decision in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995), pointing to language in that case where this Court spoke of enforcing arbitration clauses as written. *E.g.*, Pet. at 11-12. In fact, the decision below is perfectly consistent with *Mastrobuono.*

To begin with, Petitioners read far too much into *Mastrobuono.* As set forth above, this Court has recognized two major exceptions to the doctrine that arbitration clauses are to be enforced as written. *Mastrobuono* did not involve a challenge to a contract provision prohibiting arbitration clauses, but instead involved a challenge to an arbitrator's award of punitive damages to a party. Accordingly, the case did not involve a generally applicable body of state law, such as that applied by the court below here. In addition, the arbitration clause in *Mastrobuono* did not strip any party of his or her ability to effectively vindicate any substantive right under state law, as did the arbitration clause in this case.

Mastrobuono merely suggests that, as a general matter, parties may contract away any of their rights unless there is some affirmative body of substantive law that prohibits such a waiver. It was against this general backdrop, and not in the face of any particular positive state law to the contrary, that this Court suggested in *Mastrobuono* that parties are free to contract as they wish with respect to the right to recover punitive damages.

II. The Holding of the Court Below that a Contractual Ban on Class Actions Prevents Parties from Effectively Vindicating their Substantive Rights Does Not Justify a Grant of Certiorari.

A. The Decision Below Neither Creates Nor Deepens a Split of Authority.

The decision below relating to the effective ban on class actions is a straightforward application of West Virginia's long-standing and generally applicable state law relating to exculpatory clauses, and therefore is not in conflict with the cases cited by Petitioners. As the Court below made plain, a prohibition on class actions in a contract of adhesion that did not involve arbitration would also be unconscionable under West Virginia's state law. Pet. App. 41a. The Court found that Mr. Dunlap, with his claim for $8.46, and other Friedman's customers with similarly small claims, would not have been able to effectively vindicate their rights without being permitted to proceed on a class action basis.

To the extent that any of the cases cited by Petitioners reach opposite conclusions contrary to this result, this reflects a difference between the varying law of exculpatory clauses in different states. There is a growing body of law around the nation addressing the issue of whether contracts of adhesion may prohibit consumers from bringing their claims on a class action basis in cases that do not involve arbitration. It is clear from this body of law that entirely apart from arbitration issues, different states have reached different results on the question. *Compare America Online v. Superior Court*, 90 Cal. App. 4th 1, 8 (2001) (forum selection clause that required consumers to bring claims in Virginia, a state which does not permit class actions, held unconscionable under California law because

consumers could not effectively vindicate their rights in this forum) (case not involving any arbitration clause), *with Gilman v. Wheat, First Securities*, 692 A.2d 454 (Md. 1997) (enforcing identical forum selection clause, as it was not unconscionable under Maryland law) (case not involving any arbitration clause).[2]

Friedman's cites to a great many cases that do not involve state law unconscionability issues, or state law limitations on exculpatory clauses, but instead address questions of federal statutory interpretation. Decisions such as *Randolph v. Green Tree*, 244 F.3d 814 (11th Cir. 2001) and *Johnson v. W. Suburban Bank*, 225 F.3d 366 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001), involve discussions of the language and legislative history of the Truth in Lending Act. These cases say nothing about what state law may or may not be with respect to exculpatory clauses.

B. The Decision Below Is Consistent With this Court's Decisions.

Petitioners excoriate the decision below as being counter to law, on the grounds that the FAA supposedly sweeps

---

[2] This rule of Maryland state contract law, which differs from the law in some other states, explains why the Fourth Circuit's decision in *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002), does not conflict with the decision below but instead merely involves an application of a different state's contract law. The fact that the Fourth Circuit held that a contract involving Maryland residents and a Maryland business was not unconscionable because it banned class actions is an application of Maryland state law as expressed in the *Gilman* decision, and cannot be found to be in conflict with the decision below unless the FAA somehow preempts substantive state contract law by making the illegality of these types of provisions an issue of federal common law of contracts.

away state exculpatory law as it relates to the class action issue. This claim is simply incorrect. As set forth in Part I-B above, the FAA does not preempt generally applicable state law contract doctrines such as limitations on exculpatory clauses.

Petitioners attempt to get around this difficulty by claiming that any application of state law relating to exculpatory clauses to bans on class actions would necessarily bar arbitration in all cases where a class action might be pursued, and therefore that such law is preempted by the FAA. This argument is simply wrong on the merits, as there is nothing inherent to arbitration that bars class-wide relief. No one disputes that Petitioners could have drafted a contract that explicitly permits consumers to bring appropriate claims on a class action basis, but simply chose not to do so. No legal doctrine "forced" petitioners to draft their contract of adhesion in a way that would insure that their customers could never effectively vindicate their rights.

Petitioners also argue that the decision below is incorrect because West Virginia's law of exculpatory clauses is supposedly preempted by this Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991). In fact, this Court's ruling in *Gilmer* that the right to bring a class action under the federal Age Discrimination in Employment Act (ADEA) might be waivable in an arbitration contract, 500 U.S. at 32, is readily distinguishable from this case. This Court's decision in *Gilmer* was based entirely on the text and legislative purpose of the ADEA, and was in no way an interpretation of any state's contract laws with respect to exculpatory contracts.

Gilmer is also very different from this case because in *Gilmer* there was no reason to imagine that a ban on class

actions would bar the plaintiff from effectively vindicating his substantive rights. The ADEA provides for greater individual relief in the form of unpaid wages, reinstatement, other equitable relief, liquidated damages, attorney fees and costs. *See* 29 U.S.C. § 626(b) (incorporating remedies available under 29 U.S.C. §216(b)). Congress apparently was aware of the fact that ADEA claims are very different from run of the mill consumer claims (such as Mr. Dunlap's claim relating to an illegal charge of $8.56), as class actions under the ADEA proceed on an "opt-in" basis and are not governed by Rule 23's opt-out provisions for mass claims. *See, e.g., Allen v. Marshall Field & Co.*, 93 F.R.D. 438, 441 (N.D. Ill 1982). The waiver of class-wide relief in consumer cases involving very small sums of money, such as the instant case, thus poses a far greater threat to plaintiffs' ability to enforce their rights. *See, e.g., Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 339 (1980); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 809 (1985).

III. There is No Split of Authority on Whether the FAA Preempts State Contract Law Concerning Mutuality of Obligations and the Doctrine of Unconscionability.

Petitioners' assertion that the decision below exacerbates a conflict of authority on "whether Section 2 of the FAA preempts state law concerning mutuality of obligation to arbitrate" completely misses the mark. As set forth in Part I-B(1), supra, this Court has made clear that the FAA does not preempt generally applicable state law contract principles. Not one of the decisions cited by Petitioners holds that the FAA preempts such general state contract law principles of unconscionability as they would apply to a non-negotiable and one-sided arbitration provision. Although some of the decisions cited by Petitioners reach different results after

examining similar types of contracts, these results reflect variations in *state* contract law. Those laws in no way implicate the FAA's preemptive effect. Petitioners are unable to identify conflicting authority on the *federal* law issue of preemption that they raise because this Court has already answered the question conclusively in the negative.

The holding of the court below – that Petitioners' arbitration clause is unconscionable based in part on the one-sided nature of its obligations – involves a routine application of state contract law principles. In discussing the doctrine of unconscionability under West Virginia law, the court relied on its own precedent applying general statutory standards:

> The basic test is whether, in the light of the background and setting of the market, the needs of the particular trade or case, and the condition of the particular parties to the conduct or contract, the conduct involved is, or the contract or clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time the conduct occurs or is threatened or at the time of the making of the contract.

Pet. App. 14a (quoting *Arnold v. United Companies Lending Corp.*, 511 S.E.2d 854, 859-60 (W. Va. 1998) (quoting Uniform Consumer Credit Code, § 5.108 comment 3)). Based on the standards of unconscionability set forth in the Uniform Consumer Credit Code, the court held that "Friedman's retention of the right to use the courts for its most important remedies, at the same time that it denies that forum to Mr. Dunlap with respect to his most important remedies, meets our established criteria for unconscionability in the context of a

contract of adhesion." Pet. App. 31a n. 12. This application of the same state contract and consumer protection law standards as would apply to any other provision in Petitioner's contract documents does not conflict with any of the decisions cited in the petition for *certiorari*.

The differences in outcome in the state and federal court cases cited by Petitioners are based entirely on variations in state contract law, and not on conflicting interpretations of the FAA itself. In *Munoz v. Green Tree Financial Corp.*, 542 S.E.2d 360 (S.C. 2001), the court held that state contract law remains applicable under the FAA and that a one-sided consumer arbitration clause was enforceable because South Carolina law does not invalidate contracts based on a lack of mutuality of remedy. *Id.* at 364 and 365. Likewise, *Ex Parte McNaughten*, 728 So.2d 592 (Ala. 1998), enforced a one-sided employment arbitration clause in a case involving the FAA based on its finding that Alabama law's doctrine of mutuality of remedies only applied to the substantive remedies available to parties and not to procedures for obtaining such remedies. *Id.* at 598 (citing *General Securities Corp. v. Welton*, 135 So. 329, 335 (1931)). Similarly, *In re Firstmerit Bank*, 52 S.W.3d 749 (Tex. 2001) applied the Texas statutory standard of unconscionability in holding that a mobile home finance agreement's one-sided arbitration clause was enforceable. *Id.* at 757-58. Although the Texas Supreme Court found that several cases from federal courts on the question presented were persuasive, *id.* at 757 n. 35, the court did not hold that the standard of unconscionability it applied was a rule of federal law, let alone that federal law *preempted* Texas contract law.[3]

---

[3] The same is true of *Wilson Electrical Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167 (6th Cir. 1989), which simply held that this Court's precedent did not require severance of an arbitration

These cases do not conflict with the decision below on any question of federal law because all hold that the FAA applies general principles of state contract law to arbitration agreements.

The decision below is also consistent with the Third Circuit's ruling in *Harris v. Green Tree Financial Corp.*, 183 F.3d 173 (3d Cir. 1999). Although *Harris* declared broadly that "substantive federal law stands for the proposition that parties to an arbitration agreement need not equally bind each other with respect to an arbitration agreement," *id.* at 180, the court did not hold that this principle would preempt state contract law rules requiring mutuality. Instead, *Harris* looked to state contract law as support for this holding and found that Pennsylvania did not require parties to an agreement to take on equivalent obligations in order to establish the mutuality of obligation. *Id.* at 181. This reference to state law was perfectly consistent with the court's holding that "federal courts may apply state law pursuant to Section two of the FAA," so that "generally applicable contract defenses may be applied to invalidate arbitration agreements without contravening the FAA." *Id.* at 179. In short, Petitioners fail to establish that there is *any* conflicting authority on whether the FAA preempts state contract law principles concerning unconscionability and/or the mutuality of obligations.

The decision below measuring Petitioners' non-negotiable and one-sided arbitration clause against West Virginia's general statutory standards of unconscionability is

---

clause from the rest of a contract for purposes of determining the adequacy of consideration, *id.* at 169, and did not hold that the FAA preempts state contract law that would be the source of any consideration requirement in the first place.

therefore perfectly consistent not only with the cases cited in the petition for *certiorari*, but also with this Court's repeated interpretations of the FAA.

IV. The Lower Court's Ruling Is Supported by Three Independent Reasons, and if Any of Those Reasons Is Supported by Law then It Would Suffice to Justify the Result.

As the opinion below makes clear, the West Virginia Supreme Court found that the defendants' arbitration clause was substantively unconscionable for three independent and sufficient reasons. *E.g.* Pet. App. 31a, n.12 (lack of even-handedness in one-way nature of the clause was an "additional and independently adequate" ground for the court's holding). The Court also noted that under generally applicable West Virginia law, it would not re-write a contract of adhesion with the goal of stripping out individual unconscionable provisions so that the entire clause would be enforceable. Pet. App. 38-40. Accordingly, this Court should not grant *certiorari* in this case if the decision of the Court below was correct, or not in conflict with some other authority, with respect to any one of the three separate provisions of the contract that the court below held to be unconscionable.

The decision of the Court below not to rewrite the clause is an entirely legitimate exercise of generally applicable state law. Petitioners' request to the West Virginia Supreme Court that it re-write or sever any of these three provisions would merely be a unilateral offer to amend, that need not be accepted. *See* Pet. App. 39, *citing Flyer Printing Co. v. Hill*, 805 So. 2d 829 (Fla. Ct. App. 2001) (corporation may not mend an unenforceable arbitration clause by offering during litigation to pay all costs, because this was "a unilateral offer to amend

the agreement," and, "we are not authorized to remake the parties' contract."). *See also Popovich v. McDonald's*, 189 F. Supp. 2d 772, 779 (N.D. Ill. 2002) ("McDonald's offer, which is inconsistent with the parties' contract, amounts to an offer for a new contract. Popovich is under no obligation to accept McDonald's offer, and the court is in no position to impose it. As a matter of elementary contract law, McDonald's cannot unilaterally modify the existing agreement.")

In addition, as the Court below recognized, Pet. App. 40, it is improper for courts to interject themselves into bargains and re-write adhesion contracts to fix illegal or unconscionable provisions. This decision is not surprising or unusual. *See* Restatement (Second) of Contracts § 184 cmt. b ("a court will not aid a party who has taken advantage of his dominant bargaining power to extract from the other party a promise that is clearly so broad as to offend public policy by redrafting the agreement so as to make a part of the promise enforceable.")

CONCLUSION

The petition for a writ of *certiorari* should be denied.

Respectfully submitted,

F. Paul Bland, Jr.
(Counsel of Record)
Michael J. Quirk
Trial Lawyers for Public Justice , P.C.
1717 Massachusetts Ave., NW, Suite 800
Washington, D.C. 20036
202/797-8600

David Grubb
The Grubb Law Group
1324 Virginia Street, East
Charleston, WV 25301
(304) 345-3356

John W. Barrett
Barrett Law Firm, P.L.L.C.
227 Capitol Street, Suite 400
Charleston, WV 25301
(304) 414-3000

Brian A. Glasser
Bailey & Glasser, L.L.P
227 Capitol Street
Charleston, WV 25301
(304) 345-6555

Counsel for Respondent

Date: November 11, 2002